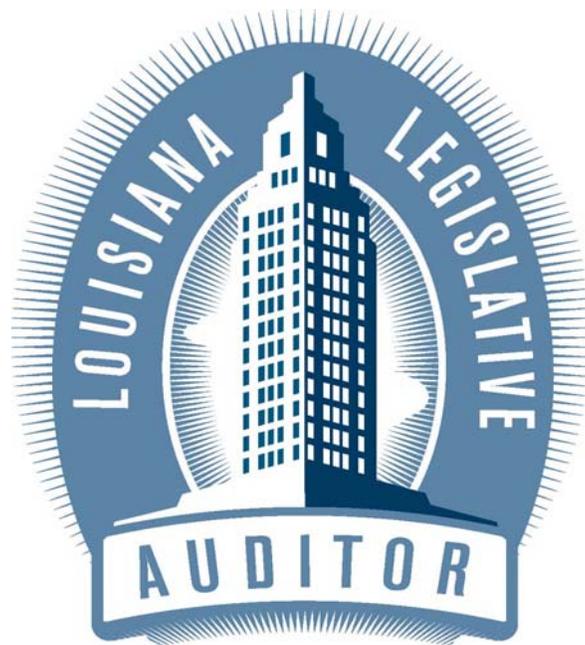


STATE RETIREMENT SYSTEMS  
HOUSE RESOLUTION No. 78



PERFORMANCE AUDIT  
ISSUED MARCH 4, 2009

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FOR QUESTIONS RELATED TO THIS PERFORMANCE AUDIT, CONTACT  
PATRICK GOLDSMITH, PERFORMANCE AUDIT MANAGER,  
AT 225-339-3800.

Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge office of the Legislative Auditor.

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LOUISIANA LEGISLATIVE AUDITOR  
STEVE J. THERIOT, CPA

March 4, 2009

The Honorable Joel T. Chaisson, II,  
President of the Senate  
The Honorable Jim Tucker,  
Speaker of the House of Representatives

Dear Senator Chaisson and Representative Tucker:

This report provides the results of our work to address House Resolution (HR) 78 of the 2008 Regular Legislative Session. HR 78 directs the legislative auditor to determine the extent to which the four state retirement systems are in compliance with Louisiana Revised Statute 11:266.1, which requires the systems to direct a certain percentage of commissions or trades of certain investments to qualified Louisiana incorporated brokers. The audit was conducted under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended.

The report contains our findings, conclusions, recommendations, and two matters of legislative consideration. Appendix D through G contains each system's response. I hope this report will benefit you in your legislative decision-making process.

Sincerely,

A handwritten signature in blue ink, appearing to read "Steve J. Theriot".

Steve J. Theriot, CPA  
Legislative Auditor

SJT/dl

RETSYS09



# Office of Legislative Auditor

Steve J. Theriot, CPA, Legislative Auditor



## State Retirement Systems House Resolution No. 78

March 2009

Audit Control # 40080010

### *Executive Summary*

House Resolution No. 78 of the Regular Legislative Session of 2008 directs the Louisiana Legislative Auditor to conduct a performance audit on the four state public retirement systems. The resolution directs the legislative auditor to determine the extent to which the state retirement systems are in compliance with Louisiana Revised Statute (R.S.) 11:266.1, which requires the systems to direct a certain percentage of commissions or trades of certain investments to qualified Louisiana incorporated brokers. HR 78 refers to the following four state public retirement systems:

- Teachers' Retirement System of Louisiana (TRSL)
- Louisiana State Employees' Retirement System (LASERS)
- Louisiana School Employees' Retirement System (LSERS)
- Louisiana State Police Retirement System (LSPRS)

The objectives of this audit and results are summarized as follows:

**Objective 1:** Are the four state retirement systems using qualified Louisiana incorporated broker-dealers per state law?

**Results:** The four state retirement systems used qualified Louisiana incorporated broker-dealers for all trades subject to R.S. 11:266.1 during January 2007 through June 2008. However, two of the four retirement systems have brokers on their approved Louisiana broker list that are not qualified as defined by the law. While the two systems did not use any of these unqualified brokers during our period of review, there is a risk that they could be used in the future if not removed from these lists.

**Objective 2:** Did the four state retirement systems direct at least ten percent of the commissions on all trades of domestic equities from January 1, 2007, to June 30, 2008, through qualified Louisiana incorporated broker-dealers per state law?

**Results:** All systems directed at least 10% of the commissions from all domestic equity trades through Louisiana incorporated broker-dealers from January 2007 through June 2008.

**Objective 3:** Did the four state retirement systems direct at least ten percent of all trades of domestic fixed income investments from January 1, 2007, to June 30, 2008, through qualified Louisiana incorporated broker-dealers per state law?

**Results:** Only one out of the four retirement systems (LSPRS) had 10% of all domestic investment grade fixed income trades with Louisiana incorporated broker-dealers. The three systems that did not have 10% stated that their investment managers are meeting the requirement of this law because of best execution as defined by the Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD). Both definitions are open-ended and subject to interpretation, which allows investment managers the discretion to approve any broker-dealers for trades. As a result, the three systems that did not meet the 10% requirement say they are still meeting the requirement of the law. In addition, LASERS considers giving Louisiana incorporated broker-dealers the opportunity to bid on 10% of all fixed income trade as meeting best execution.

**Objective 4:** Did the four state retirement systems submit accurate quarterly reports to the Legislature?

**Results:** Most of the calculations of the percentage of trades to Louisiana brokers in the legislative quarterly reports submitted by the retirement systems from January 2007 through June 2008 were accurate. Twenty-eight of the 36 (78%) calculations in the legislative reports we looked at were accurate for domestic equity and domestic investment grade fixed income. Most of the inaccuracies were small and none impacted whether or not they met the 10% domestic equity or fixed income requirement.

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### *Audit Initiation, Scope and Methodology*

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We conducted this performance audit in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit covered the period from January 1, 2007, to June 30, 2008. To answer our objectives, we performed the following audit steps:

- Interviewed the executive director for LSPRS regarding domestic equity trades and fixed income investments.
- Interviewed chief investment officers for TRSL, LASERS, and LSERS regarding compliance issues related to R.S. 11:266.1.
- Interviewed other key personnel at TRSL, LASERS, LSERS, and LSPRS regarding issues related to domestic equity trades, fixed income investments, and the preparation of legislative quarterly reports.
- Interviewed a chief executive officer of a Louisiana incorporated broker on increasing business for Louisiana broker-dealers.
- Interviewed retirement systems' investment managers, via telephone, on best execution and their processes for selecting brokers.

- Obtained and examined domestic equity and fixed income investment data provided by each retirement system.
- Accessed, downloaded, and verified domestic equity and fixed income trade data from each retirement system’s custodian database.
- Reviewed the Louisiana Secretary of State’s (SOS) corporate database and verified that the broker-dealers were in good standing with NASD by reviewing the Financial Industry Regulatory Authority (FINRA) Web site.

**Appendix D** contains TRSL’s response to the report.

**Appendix E** contains LASERS’ response to the report.

**Appendix F** contains LSERS’ response to the report.

**Appendix G** contains LSPRS’ response to the report.

***Overview of R.S. 11:266.1***

**Legal Authority** - R.S. 11:266.1 requires that each state retirement system does the following:

- Direct at least 10% of the commissions on all domestic equities trades (stocks) in separately actively managed portfolios subject to best efforts and best execution
- Direct at least 10% of all domestic investment grade fixed income investments trades (bonds) selected on a best bid and offer basis subject to best execution
- Direct these trades to broker-dealers domiciled in or who have principal trading operations in Louisiana for at least two years, and who are registered and in good standing with the NASD and who have demonstrated the ability to execute institutional domestic equity and fixed income transactions
- All trades shall be subject to best efforts and best executions as defined by the SEC and NASD
- Submit to the House and Senate committees on retirement quarterly and annual progress reports detailing the system's investments which comply with the provisions of this law

**Trade Definitions**

**Domestic Equity Trades** - The buying or selling of U.S. company *stock* on a recognized exchange held in a portfolio that is part of the domestic equity asset class allocation where the designated company is incorporated within the United States.

**Domestic Investment Grade Fixed Income Trades** - The purchase and sale of a U.S. firm’s *bonds* (government, corporate or municipal bonds) through a broker, held in a portfolio that is part of a domestic fixed income asset class allocation. The U.S. firm must be incorporated within the United States.

**Actively Managed Portfolios** - A portfolio that is managed with the intention to outperform the stated benchmark (a market index), using the managers’ fundamental or quantitative research to select the securities to be included or excluded and when to make changes.

**Source:** Prepared by legislative auditor’s staff using information from state public retirement systems.

The provisions of R.S. 11.266.1 are implemented as a pilot program and are set to expire on June 30, 2010.

### Market Value of Systems' Portfolios

The market value of the assets in the four systems' portfolio as of October 31, 2008, ranges from \$11.3 billion to \$330 million (see Exhibit 1). Not all of the systems' assets within the portfolios are subject to R.S. 11:266.1. The total assets subject to this law range from 20.8% to 54.1%. Appendix A defines the assets that make up the retirement systems' portfolio.

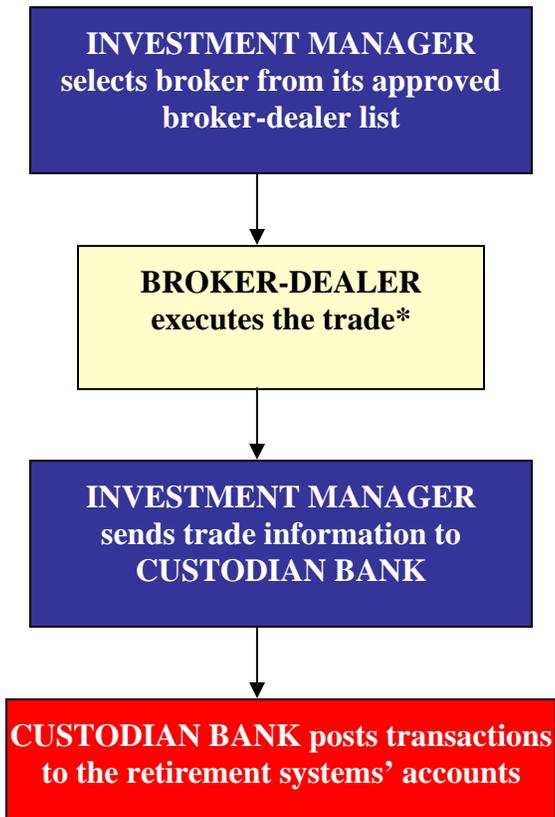
<b>Exhibit 1</b> <b>Percent of Each Retirement System's Portfolio</b> <b>Subject to R.S. 11:266.1</b> <b>As of October 31, 2008</b>			
State Retirement System	Market Value of Retirement System's Portfolio (Millions)	Total Domestic Equity Assets and Fixed Income Assets (Millions)	Percent of Portfolio Subject to R.S. 11:266.1
TRSL	\$11,323	\$3,349	29.57%
LASERS	6,758	1,404	20.77%
LSERS	1,188	643	54.12%
LSPRS	330	129	39.09%
<b>Total</b>	<b>\$19,599</b>	<b>\$5,525</b>	<b>28.2%</b>
<b>Source:</b> Prepared by legislative auditor's staff using information provided by each retirement system.			

### Entities Involved in the Trade Process

In general, there are three entities involved with the domestic equity and fixed income trade process. They include the investment manager, the broker-dealer, and the custodian. The investment manager is a professional responsible for a portion of the securities portfolio of an individual or institutional investor. In return for a fee, an investment manager has the fiduciary responsibility to manage a portfolio prudently and choose whether stocks, bonds, cash equivalents, or some other asset presents the best opportunities for profit at any particular time. A broker-dealer is an individual or firm that buys and sells securities for an institution usually charging a commission. Finally, a retirement system's custodian is a bank that holds all assets (stocks, bonds, cash, et cetera), collects the income, settles the trades that are executed by managers, and posts all of these transactions to specific accounts.

**Domestic Equity Trade Process** - As stated previously, R.S. 11:266.1 requires that each state public retirement system shall direct at least ten percent of the commissions on all trades of domestic equities subject to best efforts and best execution in separately actively managed portfolios through qualified Louisiana incorporated broker-dealers. Exhibit 2 shows a general domestic equity trade process between an investment manager and a broker-dealer.

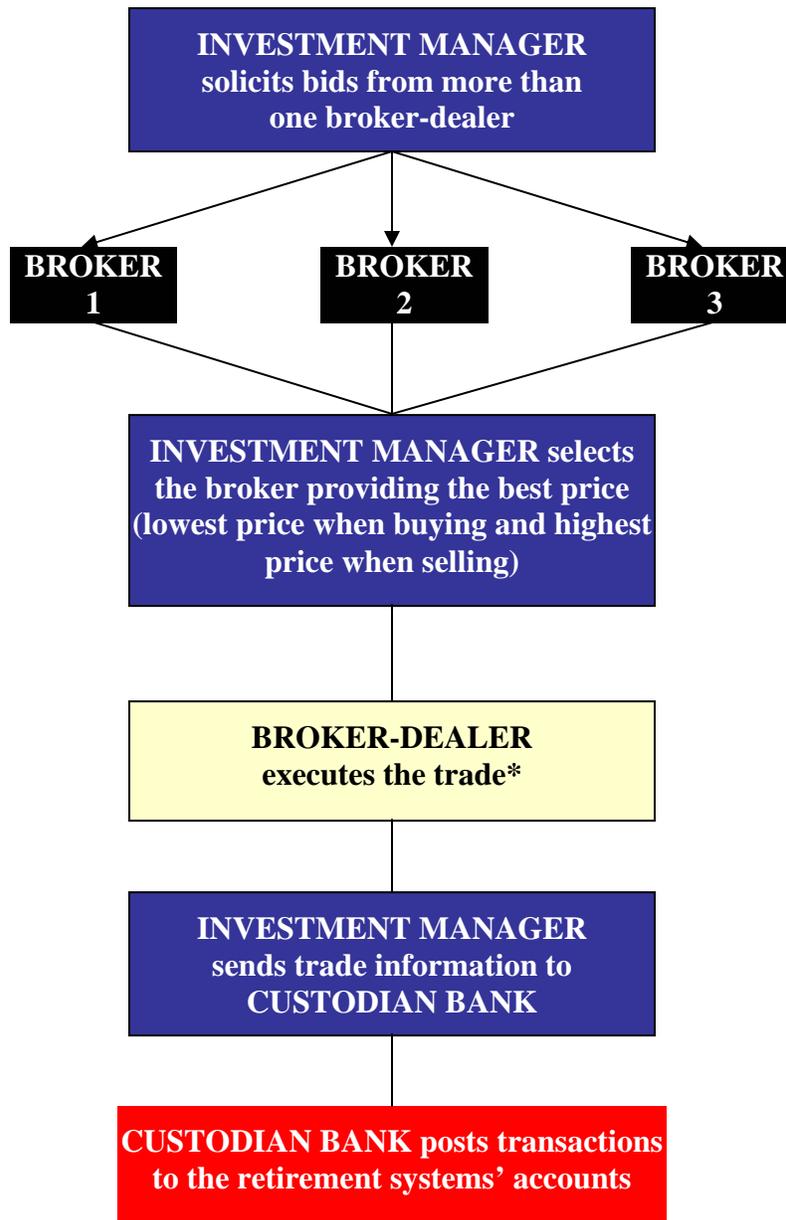
**Exhibit 2  
Domestic Equity Trade Process (Stocks)**



**Source:** Prepared by legislative auditor’s staff using information provided by each retirement system.  
\*Some broker-dealers use clearing agents to execute a trade.

**Fixed Income Trade Process** - R.S. 11:266.1 also requires each state public retirement system to direct at least ten percent of all trades of domestic investment grade fixed income investments in separately managed accounts through qualified Louisiana incorporated broker-dealers selected on a best bid and offer basis subject to best execution. Exhibit 3 shows a general fixed income trade process between an investment manager and a broker-dealer.

**Exhibit 3**  
**Fixed Income Trade Process (Bonds)**



**Source:** Prepared by legislative auditor's staff using information provided by each retirement system.

\*Some broker-dealers use clearing agents to execute a trade.

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***Objective 1: Are the four state retirement systems using qualified Louisiana incorporated broker-dealers per state law?***

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The four state retirement systems used qualified Louisiana incorporated broker-dealers for all trades subject to R.S. 11:266.1 during January 2007 through June 2008. However, two of the four retirement systems have brokers on their approved Louisiana broker list that are not qualified as defined by the law. While the two systems did not use any of these unqualified brokers during our period of review, there is a risk that they could be used in the future if not removed from these lists.

**All of the Louisiana brokers used by the systems during our period of review were qualified Louisiana incorporated broker-dealers.** According to R.S. 11:266.1, broker-dealers must be incorporated and domiciled in or have had their principal trading operations in Louisiana for at least two years. In addition, broker-dealers are to be registered and in good standing with the NASD.<sup>1</sup> We verified that the broker-dealers were incorporated and domiciled in Louisiana for at least two years by reviewing the Louisiana Secretary of State's (SOS) corporate database and that the brokers were in good standing with NASD by reviewing the Financial Industry Regulatory Authority (FINRA) Web site.

**Two of the four retirement systems had broker-dealers on their approved Louisiana broker lists that were not qualified according to the SOS and FINRA Web sites.** Each system has a list of Louisiana incorporated broker-dealers approved by their investment managers for trading. LSERS and LSPRS each had two broker-dealers (for a total of four) on their lists that were not qualified per state law. Overall, all systems have a total of 15 Louisiana incorporated broker-dealers on these lists. Appendix B lists the current status of all 15 Louisiana broker-dealers used by the retirement systems.

Although none of these two systems used any of these four broker-dealers for trading during the scope of our audit, LSERS and LSPRS do not have a process to ensure that all Louisiana incorporated broker-dealers on their lists are qualified as defined by state law. As a result, these systems are at risk for using unqualified Louisiana broker-dealers for trades. Overall, 11 qualified Louisiana incorporated broker-dealers earned commissions from domestic equity trades during January 2007 through June 2008.

**Recommendation 1:** LSERS and LSPRS should develop a process to annually check with SOS and FINRA on the status of each Louisiana incorporated broker-dealer on their approved broker list to ensure only qualified broker-dealers are on the approved list.

**Summary of LSERS' Response:** LSERS agrees with this recommendation and will review the list at least annually in the future.

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<sup>1</sup> NASD has been changed to the Financial Industry Regulatory Authority (FINRA). FINRA was formed by a consolidation of the enforcement arm of the New York Stock Exchange and the NASD. FINRA is a non-governmental regulator of all security firms conducting business in the United States.

**Summary of LSPRS' Response:** LSPRS agrees that they should develop a process to annually check the status of each Louisiana incorporated broker-dealer. LSPRS has requested that the system consultant develop an addendum to LSPRS' Investment Policy to include a process to ensure that each broker-dealer included on the system's broker-dealer list is in good standing.

**Recommendation 2:** LSERS and LSPRS should remove any Louisiana broker-dealer not active or not in good standing with SOS or FINRA from their approved Louisiana incorporated broker-dealer list.

**Summary of LSERS' Response:** LSERS agrees with this recommendation and has updated and removed those brokers no longer in good standing from the list of Louisiana broker-dealers.

**Summary of LSPRS' Response:** As part of the above requested policy, LSPRS will immediately remove any and all broker-dealers who are not in good standing.

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***Objective 2: Did the four state retirement systems direct at least ten percent of the commissions on all trades of domestic equities through qualified Louisiana incorporated broker-dealers per state law?***

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All systems directed at least 10% of the commissions from all domestic equity trades through Louisiana incorporated broker-dealers from January 2007 through June 2008. R.S. 11:266.1 authorizes each state public retirement system to direct at least 10% of the commissions on all trades of domestic equities in separately managed portfolios through Louisiana incorporated broker-dealers. We determined the amount of commissions earned by qualified broker-dealers by downloading "broker commission reports" from the systems' custodian database and match those amounts to the required brokerage reports the systems submitted to the Legislature from January 2007 through June 2008.<sup>2</sup> Appendix C is a quarterly breakdown of percentage of commissions earned by Louisiana incorporated broker-dealers from January 2007 through June 2008.

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<sup>2</sup> Broker commission reports contain trade information for each system such as the account manager, broker name, trade date, asset type, and broker commissions.

<b>Exhibit 4</b>			
<b>Louisiana Incorporated Broker-Dealers Domestic Equity Trades (January 2007 Through June 2008)</b>			
<b>System</b>	<b>Total Commissions</b>	<b>Commissions Earned by La Inc Brokers</b>	<b>Percent of Commissions Directed to La Inc Brokers</b>
TRSL	\$10,646,887	\$1,265,962	11.89%
LASERS	2,231,264	241,239	10.81%
LSERS	1,269,332	172,168	13.56%
LSPRS	154,020	18,622	12.09%
<b>Total</b>	<b>\$14,301,503</b>	<b>\$1,697,991</b>	<b>11.87%</b>
<b>Source:</b> Prepared by legislative auditor's staff using information provided by each retirement system.			

The amount of commissions earned from the 11 Louisiana incorporated broker-dealers ranges from \$487,610 to \$9,583. Exhibit 5 summarizes this information.

<b>Exhibit 5</b>		
<b>Louisiana Incorporated Brokers Percent of Commissions Earned From Domestic Equity Trades (January 2007 Through June 2008)</b>		
<b>Louisiana Incorporated Brokers</b>	<b>Commissions Earned Through Domestic Equity Trades</b>	<b>Percent of Commissions Earned by Louisiana Incorporated Brokers</b>
Sisk Investment	\$487,610	28.72%
Johnson Rice & Company	246,658	14.53%
Dorsey & Company	197,271	11.62%
Cullen Investment Group	185,527	10.92%
Hibernia Southcoast (Capital One)	174,406	10.27%
Sisung Securities	163,175	9.61%
Francis Financial	111,062	6.54%
Pritchard Capital Partners	59,379	3.50%
First Bank & Trust (FBT)	38,642	2.28%
Doley Securities	24,678	1.45%
Howard Weil	9,583	.56%
<b>Total</b>	<b>\$1,697,991</b>	<b>100%</b>
<b>Source:</b> Prepared by legislative auditor's staff using information provided by each retirement system.		

***Objective 3: Did the four state retirement systems direct at least ten percent of all trades of domestic fixed income through qualified Louisiana incorporated broker-dealers per state law?***

Only one out of the four retirement systems (LSPRS) had 10% of all domestic investment grade fixed income trades with Louisiana incorporated broker-dealers. The three systems that did not have 10% stated that their investment managers are meeting the requirement of this law because of best execution as defined by the SEC and NASD. Both definitions are open-ended, which allows investment managers the discretion to approve any broker-dealers for trades. As a result, the three systems that did not meet the 10% requirement say they are still meeting the requirement of the law. In addition, LASERS considers giving Louisiana incorporated broker-dealers the opportunity to bid on 10% of all fixed income trade as meeting best execution.

### Ten Percent Fixed Income Requirement

R.S. 11:266.1 authorizes each state public retirement system to direct at least 10% of all trades of domestic investment grade fixed income investments through Louisiana incorporated broker-dealers through broker-dealers selected on a best bid and offer basis subject to best execution. As seen in Exhibit 6, LSPRS is the only system that had 10% of domestic investment grade fixed income with Louisiana incorporated broker-dealers. LSPRS directed 11.2% of all domestic investment grade fixed income trades through Louisiana incorporated brokers. Overall, only 20 domestic investment grade fixed income securities have been traded through Louisiana incorporated broker-dealers during our period of review.

<b>Exhibit 6</b>				
<b>Fixed Income Bids Won by Louisiana Incorporated Broker-Dealers January 2007 Through June 2008</b>				
<b>System</b>	<b>Number of Fixed Income Trades Won by La Inc Broker-Dealers</b>	<b>Total Fixed Income Trades</b>	<b>Fixed Income Trades Won by La Inc Broker- Dealers</b>	<b>Percent of Fixed Income Trades Directed to La Inc Broker- Dealers</b>
TRSL	0	\$6,762,061,331	\$0	0%
LASERS	9	919,892,340	27,142,042	2.95%
LSERS	7	3,103,413,047	14,985,412	.48%
LSPRS	4	28,635,067	3,195,705	11.2%
<b>Total</b>	<b>20</b>	<b>\$10,814,001,785</b>	<b>\$45,323,159</b>	<b>.42%</b>
<b>Source:</b> Prepared by legislative auditor's staff using information provided by each retirement system.				

**Best Execution**

R.S. 11:266.1(C) states that all trades shall be subject to best efforts and best execution as defined by the SEC and NASD. Each retirement system interprets best execution to mean that its investment managers are to select the best deal from the qualified broker-dealers. This could mean that Louisiana incorporated broker-dealers are allowed to bid or compete for a trade. Whether, they win or lose the bid, the retirement systems say that they met best execution because Louisiana incorporated broker-dealers had the opportunity to bid. Also, this could mean that no Louisiana incorporated broker-dealer was allowed to bid because of best execution. According to the retirement systems, Louisiana incorporated broker-dealers are not competitive and the managers would violate the concept of best execution by giving them more trades.

As stated previously, the statutory definition of best execution is open-ended. Both definitions give specific factors to be considered when determining best execution, but both also say that other factors can be considered. Such other factors may include technological infrastructure, transaction costs, research services or market impact. Therefore, state law allows each money manager used by the retirement system to use his/her interpretation of best execution.

Because the definitions of best execution are open-ended and subject to interpretation by each system, it is difficult to determine if excluding Louisiana brokers is meeting best execution. One would have to determine each investment manager’s definition of best execution and compare against all trades conducted during a specific period of time. As a result, we were not able to test if these trades, which excluded Louisiana incorporated brokers, met the best execution definition.

**LASERS considers giving the local broker-dealers the opportunity to compete or bid on ten percent of all domestic investment grade fixed income trades as meeting best execution.** R.S. 11:266.1 states that each system shall direct at least ten percent of all trades of domestic investment grade fixed income investments . . . through broker-dealers selected on a best bid and offer basis who have been incorporated and domiciled in Louisiana. LASERS interprets the law to mean giving Louisiana broker-dealers the opportunity to bid on 10% of all trades. While they have the opportunity to bid on 10% of the trades, they may not win 10% of trades.

**BEST EXECUTION DEFINITIONS:**

**SEC** - In deciding how to execute orders, your broker has a duty to seek the best execution that is reasonably available for its customers. Brokers must evaluate *some factors* when considering best execution to include, the opportunity to get a better price than what is currently quoted, the speed of execution, and the likelihood trade will be executed.

**Source:** U.S. Securities and Exchange Commission

**NASD** - Any transaction for or with a customer shall use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. *Some factors* that will be considered in determining whether a member has used “reasonable diligence” are price, volatility, relative liquidity, and pressure on available communications, the size and type of transaction, the number of primary markets checked, and the location and accessibility to the customer’s broker/dealer of primary markets and quotations sources.

**Source:** Financial Industry Regulatory Authority

LASERS tracks the total volume of domestic investment grade fixed income trades sent to broker-dealers for bidding in its quarterly reports. LASERS gave Louisiana incorporated broker-dealers the opportunity to bid in all six quarters. LASERS domestic investment grade fixed income portfolio during our scope had a total of \$919 million. A total of \$129 million (14.03%) of the domestic investment grade fixed income trades were directed to Louisiana incorporated broker-dealers for bidding.

**Matter for Legislative Consideration 1:** Due to the open-ended nature of best execution, the Legislature may need to clarify the intent of this legislation. The following are two possible options:

1. If the intent of the legislation is to encourage business for Louisiana broker-dealers, then the current law is sufficient.
2. If the intent of the legislation is to establish a percentage of business for Louisiana broker-dealers regardless of best execution, then the Legislature may amend R.S. 11:266.1 to require the retirement systems to direct a certain percentage of trades through Louisiana incorporated broker-dealers without requiring best execution.

**Matter for Legislative Consideration 2:** If the intent of the legislation is to simply allow Louisiana incorporated broker-dealers the opportunity to bid on 10% of all domestic investment grade fixed income trades, as opposed to awarding 10% of all domestic investment grade fixed income trades to Louisiana incorporated broker-dealers, then the Legislature should consider clarifying the law.

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***Objective 4: Did the four state retirement systems submit accurate quarterly reports to the Legislature?***

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**Most of the calculations of the percentage of trades to Louisiana brokers in the legislative quarterly reports submitted by the retirement systems from January 2007 through June 2008 were accurate.** Twenty-eight of the 36 (78%) calculations in the legislative reports we looked at were accurate for domestic equity and domestic investment grade fixed income. Most of the inaccuracies were small and none impacted whether or not they met the 10% domestic equity or fixed income requirement. R.S. 11:266.1(E) states that each system shall submit to both the House and Senate Committees on Retirement, quarterly progress reports detailing the systems domestic equity trade and domestic fixed income trade activity. Each system develops the legislative quarterly reports from its custodian's database by manually selecting each investment manager subject to R.S. 11:266.1. To determine if the legislative quarterly reports were accurate, we reconciled each system's custodian trade data to its quarterly reports. If we could not reconcile the reports, we calculated the percentage difference between the custodian data and the reports. If the percentage difference was more than 4% for a quarter, then we considered the trade data in the quarterly reports to be inaccurate.

**Domestic Equity Trades** - Most of the quarterly legislative reports, 18 of 24 (75%), accurately calculated the percentage of domestic equity trades that went to Louisiana brokers. For the six reports that did not have accurate calculations, the percentage difference between the legislative report and the actual number ranged from 4.1% to 14.9%. In addition, of the six that were not accurate, four actually reported a lower percentage of trades going to Louisiana brokers than actually occurred. Exhibit 7 details which six quarterly reports had inaccurate calculations and the percentage difference for each.

<b>Exhibit 7</b>				
<b>Inaccurate Legislative Quarterly Reports and the Percent Difference</b>				
<b>System</b>	<b>Quarterly Report</b>	<b>Percent Commissions to La Inc Broker-Dealers (Quarterly Reports)</b>	<b>Percent Commissions to La Inc Broker-Dealers (LLA)</b>	<b>Total Percent Difference</b>
TRSL	3 <sup>rd</sup> Quarter 2007	13.36%	13.91%	4.12%
LASERS	2 <sup>nd</sup> Quarter 2008	8.55%	9.83%	14.97%
LSPRS	1 <sup>st</sup> Quarter 2007	15.65%	14.61%	-6.65%
LSPRS	2 <sup>nd</sup> Quarter 2007	9.13%	9.53%	4.38%
LSPRS	4 <sup>th</sup> Quarter 2007	10.12%	10.74%	6.13%
LSPRS	2 <sup>nd</sup> Quarter 2008	10.76%	9.16%	-14.87%
<b>Source:</b> Prepared by legislative auditor's staff using information provided by each retirement system.				

**Domestic Investment Grade Fixed Income Trades** - Two retirement systems did not report domestic investment grade fixed income during the scope of our audit. For the two systems that did report, 10 of 12 (83.3%) accurately calculated the percentage of domestic investment grade fixed income trades that went to Louisiana brokers. For the two calculations that were not accurate, one actually reported a lower percentage of trades going to Louisiana brokers than actually occurred. See Exhibit 8 for results.

<b>Exhibit 8</b>				
<b>Inaccurate Legislative Quarterly Reports and the Percent Difference</b>				
<b>System</b>	<b>Quarterly Report</b>	<b>Percent Commissions to La Inc Broker-Dealers (Quarterly Reports)</b>	<b>Percent Commissions to La Inc Broker-Dealers (LLA)</b>	<b>Total Percent Difference</b>
TRSL	<b>Did Not Report</b>			
LASERS	1 <sup>st</sup> Quarter 2007	13.60%	9.54%	-29.85%
LASERS	4 <sup>th</sup> Quarter 2007	0%	10.28%	-
LSPRS	<b>Did Not Report</b>			
<b>Source:</b> Prepared by legislative auditor's staff using information provided by each retirement system.				

Examples of why calculations in the quarterly reports were inaccurate include simple transcription errors or systems failing to include certain accounts of domestic or fixed income trades. Exhibit 9 lists explanations of why each system submitted incorrect legislative quarterly reports.

<b>Exhibit 9</b>	
<b>Reasons for Inaccurate Quarterly Reports</b>	
<b>Retirement System</b>	<b>Reasons</b>
TRSL	<ul style="list-style-type: none"> <li>• TRSL failed to include certain domestic equity trades.</li> <li>• TRSL failed to include certain domestic equity investment manager accounts when preparing the quarterly reports.</li> </ul>
LASERS	<ul style="list-style-type: none"> <li>• Transcription Errors</li> <li>• LASERS failed to include two fixed income investment manager accounts when preparing the quarterly reports.</li> </ul>
LSERS	<ul style="list-style-type: none"> <li>• Transcription Errors</li> <li>• LSERS failed to include one fixed income trade.</li> </ul>
LSPRS	<ul style="list-style-type: none"> <li>• Commissions earned off foreign stock were being included in the quarterly reports.</li> <li>• LSPRS failed to include in its quarterly reports all fixed income trades won by Louisiana incorporated brokers.</li> </ul>
<b>Source:</b> Prepared by legislative auditor's staff using information provided by each retirement system.	

**Recommendation 3:** LSPRS should not include commissions earned from foreign stock when preparing its legislative quarterly reports.

**Summary of LSPRS' Response:** LSPRS will make every effort to comply with this recommendation. However, due to the nature of the software program that we are grouped within (with our custodian JPMorgan), we must consider any cost issues to the system if the recommended change necessitates a software upgrade. However, we will exhaust every effort to correct this issue.

**Recommendation 4:** LSPRS should include fixed income trades directed to Louisiana incorporated brokers in its legislative quarterly reports.

**Summary of LSPRS' Response:** LSPRS will make every effort to comply with this recommendation.

**Recommendation 5:** The four systems should review the legislative quarterly reports to ensure they are accurate before submitting to the Legislature.

**Summary of TRSL's Response:** TRSL will review quarterly reports prior to submitting them to the Legislature as recommended.

**Summary of LASERS' Response:** LASERS agrees that the system should review the Legislative quarterly report to ensure accuracy prior to submission to the Legislature.

**Summary of LSERS' Response:** The computation of the commissions paid to Louisiana broker-dealers is a completely manual process and as such is very time consuming and prone to minor errors and oversights, however every effort is and will be made to ensure the accuracy of the reports submitted.

**Summary of LSPRS' Response:** LSPRS agrees that the Legislative quarterly reports should be reviewed for accuracy prior to submission and we will make every effort to assure the accuracy of these reports.

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**APPENDIX A: Terms of Systems Assets Types**

**Domestic Equity Trades** - The buying or selling of U.S. company stock - as opposed to bonds - on a recognized exchange held in a portfolio that is part of the domestic equity asset class allocation. Domestic equity trades are those stock shares that are bought or sold where the designated company is incorporated within the United States.

**Domestic Fixed Income Trades** - Fixed income refers to any type of investment that yields a regular (fixed) return. A domestic fixed income trade is the purchase and sale of a U.S. firm's bonds (government, corporate or municipal bonds) through a broker, held in a portfolio that is part of a domestic fixed income asset class allocation. The U.S. firm must be incorporated within the United States.

**International Equity Trades** - The buying or selling of non-U.S. company stock in companies domiciled outside the United States.

**Global Fixed Income** - Global fixed income is defined as fixed income investments (i.e., bonds) from borrowers inside and outside of the United States.

**Alternative Assets** - Alternative assets are investments considered outside of the traditional asset classes of stocks, bonds and cash. Examples include real estate, commodities, timber, hedge funds, private equity, and other financial derivatives.

**Cash** - Cash includes paper currency and coins on hand, negotiable money orders and checks. In financial statements of annual reports, cash is usually grouped with cash equivalents defined as highly liquid securities with a known market value.

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## APPENDIX B: Current Status of Louisiana Incorporated Brokers

Louisiana Incorporated Brokers Status			
Louisiana Incorporated Broker	Filing Date	FINRA Status	SOS Status
Brockhouse & Cooper	Not Listed	Not Listed	Not Listed
Cullen Investment Group	10/15/1986	Active, No Suspensions	Active, In Good Standing
Doley Securities	10/14/2005	Active, No Suspensions	Active, In Good Standing
Dorsey and Company	5/27/1959	Active, No Suspensions	Active, In Good Standing
Equitas Capital Advisors	8/23/2002	Not Listed	Active, In Good Standing
First Bank and Trust (FBT)	8/9/2000	Active, No Suspensions	Active, In Good Standing
Francis Financial	1/18/2001	Active, No Suspensions	Active, In Good Standing
Hattier, Sanford & Reynoir	1/2/1981	Inactive	Active, In Good Standing
Hibernia Southcoast Capital (Capital One)	10/27/1999	Active, No Suspensions	Active, In Good Standing
Howard Weil	11/17/1986	Active, No Suspensions	Active, In Good Standing
Johnson Rice and Company	1/25/1994	Active, No Suspensions	Active, In Good Standing
Oro Financial	8/25/1987	Inactive	Active, Not in Good Standing
Pritchard Capital Partners	7/28/1999	Active, No Suspensions	Active, In Good Standing
Sisk Investment	2/12/1987	Active, No Suspensions	Active, In Good Standing
Sisung Securities	11/20/1989	Active, No Suspensions	Active, In Good Standing
<b>Source:</b> Prepared by legislative auditor's staff using information provided by each retirement system.			

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## APPENDIX C: Percent of Trades Per Quarter

### Domestic Equity Trades

<b>Percent of Domestic Equity Trades to Louisiana Incorporated Broker-Dealers January 2007 Through June 2008</b>						
System	1 <sup>st</sup> Quarter 2007	2 <sup>nd</sup> Quarter 2007	3 <sup>rd</sup> Quarter 2007	4 <sup>th</sup> Quarter 2007	1 <sup>st</sup> Quarter 2008	2 <sup>nd</sup> Quarter 2008
TRSL	12.01%	10.89%	13.91%	10.31%	11.69%	13.09%
LASERS	10.71%	9.36%	10.24%	12.34%	12.46%	9.83%
LSERS	13.47%	7.86%	11.69%	16.53%	17.26%	12.16%
LSPRS	14.61%	9.53%	12.95%	10.74%	15.79%	9.16%

**Source:** Prepared by legislative auditor's staff using information provided by each retirement system.

### Domestic Investment Grade Fixed Income Trades

<b>Percent of Investment Grade Fixed Income Trades to Louisiana Incorporated Broker-Dealers January 2007 Through June 2008</b>						
System	1 <sup>st</sup> Quarter 2007	2 <sup>nd</sup> Quarter 2007	3 <sup>rd</sup> Quarter 2007	4 <sup>th</sup> Quarter 2007	1 <sup>st</sup> Quarter 2008	2 <sup>nd</sup> Quarter 2008
TRSL	0%	0%	0%	0%	0%	0%
LASERS	9.54%	0%	0%	10.28%	0%	1.55%
LSERS	0%	.22%	0%	1.83%	.14%	.52%
LSPRS	9.53%	0%	0%	63.49%	0%	14.04%

**Source:** Prepared by legislative auditor's staff using information provided by each retirement system.

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**APPENDIX D: TRSL Management's Response**

See the following pages for the response we received from TRSL regarding our conclusions and recommendations.

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Teachers' Retirement System of Louisiana

RECEIVED LEGISLATIVE AUDITOR

www.trsl.org
225.925.6446
225.925.6366
web.master@trsl.org/
Post Office Box 94123
Baton Rouge LA 70804-9123

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General Counsel
Roy A. Mongrue, Jr.

Executive Staff Officer
Lisa Barousse

Executive Assistant
Dana Lee Haltom

February 23, 2009

Mr. Steve Theriot, CPA
Louisiana Legislative Auditor
P.O. Box 94397
Baton Rouge, Louisiana 70804-9397

RE: H.R. 78 Performance Audit

Dear Mr. Theriot:

Teachers' Retirement System of Louisiana (TRSL) would like to thank you and your staff for the professional manner in which you conducted the performance audit directed by H.R. 78. We appreciate your recognition that our process for identifying and using only qualified Louisiana brokers has proven to be successful and complies with state law. TRSL strives to invest in Louisiana whenever such an investment is in the best interest of our members and beneficiaries.

We offer the following specific responses to your report:

Objective 1 - TRSL agrees that our system used qualified Louisiana incorporated broker dealers as required by state law.

Objective 2 - TRSL agrees that our system directed at least 10% of the commissions from all trades of domestic equities through qualified Louisiana-incorporated broker dealers during the audit period as required by state law.

Objective 3 - TRSL agrees that our system has complied with R.S. 11:266.1. To meet the 10% trading requirement, the law states that:

- 1. Broker dealers be "selected on a best bid and offer basis"
2. Broker dealers have "demonstrated the ability to execute institutional domestic equity and fixed income transactions"
3. "All trades shall be subject to best efforts and best execution"

While TRSL provided Louisiana broker dealers with trading opportunities valued at \$137 million during the audit period, none met the above criteria.

**Objective 4** – TRSL agrees that our system submitted accurate reports to the Legislature as required by law. We agree that one report understated the commissions TRSL paid to Louisiana brokers by 0.55%, and that this small difference was immaterial and had no impact on meeting the 10% requirement. TRSL will review quarterly reports prior to submitting them to the Legislature as recommended.

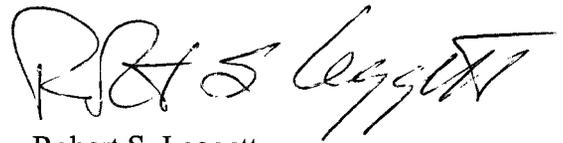
**Matters for Legislative Consideration 1 and 2** – Thank you for amending the report to include the complete language of R.S. 11:266.1. We believe that this law requires the systems to act in the best interests of their members in all transactions with Louisiana broker dealers, as evidenced by the “best bid and offer,” “demonstrated ability,” and “best execution” provisions of the statute.

We appreciate the professionalism and cooperation exhibited by your staff during this process. Thank you for your assistance and please do not hesitate to contact us if we can assist you in the future.

Sincerely,



Maureen H. Westgard  
Director



Robert S. Leggett  
Chief Investment Officer

## APPENDIX E: LASERS Management's Response

See the following pages for the response we received from LASERS regarding our conclusions and recommendations.

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February 20, 2009

Steve Theriot, Legislative Auditor  
Louisiana State Legislative Auditor  
Post Office Box 94397  
Baton Rouge, LA 70804-9397

ATTN: David K. Greer, CPA

RE: Performance Audit Revised Draft Report per H.R. No. 78 of the 2008 Regular  
Legislative Session

Dear Mr. Theriot:

We appreciated the opportunity to work with your staff regarding the above-referenced legislative resolution. The meetings with your staff provided us with an opportunity to demonstrate that our agency is in fact in compliance with the requirements of H.R. 78.

Our specific responses to the revised draft are as follows:

Objective 1 – LASERS agrees that our system used qualified Louisiana incorporated broker-dealers per state law.

Objective 2 – LASERS agrees that our system directed at least 10% of the commissions from all domestic equity trades through Louisiana incorporated broker-dealers from January 2007 through June 2008.

Objective 3 – LASERS agrees that our system is meeting the requirements of this law because of best execution as defined by SEC and NASD. LASERS further agrees that both definitions are open ended, which allows the investment managers the discretion to approve any broker-dealer for trades. We would further emphasize that, while the report states that "LASERS considers giving Louisiana incorporated broker-dealers the opportunity to bid on 10% of all fixed income trade as meeting *best execution*," the report could more accurately state that "LASERS considers giving Louisiana incorporated broker-dealers the opportunity to bid on 10% of referenced fixed income trades as meeting ***the requirement of the law while maintaining best execution.***"

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Virginia Burton  
Sen. D.A. "Butch" Gautreaux  
Louis S. Quinn  
Judge Trudy M. White

Cindy Rougeou, Executive Director

Objective 4 – LASERS agrees that our system did submit accurate reports to the Legislature as required by law. We further agree that calculations that contained discrepancies were small, immaterial, and had no impact on the legislative requirement. LASERS further agrees that the systems should review the Legislative quarterly report to ensure accuracy prior to submission to the Legislature.

Matters for Legislative Consideration 1 and 2: We believe that the language in R.S. 11:266.1 clearly requires the systems to act, at all times, subject to best efforts and best execution, as well as (with respect to domestic investment grade fixed income) on a best bid and offer basis subject to best execution. This language is critically important and reflects our understanding of the legislative intent, to encourage rather than demand business for Louisiana broker dealers.

Thank you again for the opportunity to work with you and your staff. Please contact me if we may be of any further assistance.

Sincerely,



Cynthia Y. Rougeon  
Executive Director

## APPENDIX F: LSERS Management's Response

See the following pages for the response we received from LSERS regarding our conclusions and recommendations.

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State of Louisiana  
**SCHOOL EMPLOYEES' RETIREMENT SYSTEM**

P. O. BOX 44516  
BATON ROUGE, LOUISIANA 70804-4516  
Telephone: (225) 925-6484  
<http://www.lasers.state.la.us>

February 23, 2009

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4th Retirement District

David K. Greer, CPA  
Louisiana Legislative Auditor  
1600 North Third Street  
Baton Rouge, Louisiana 70804-9397

RE: House Resolution No 78 Audit Report

Dear Mr. Greer:

Thank you for the hard work and professional manner your staff demonstrated in thoroughly reviewing Louisiana School Employees' Retirement System's (LSERS) compliance with R.S. 11:266.1 and the opportunity to demonstrate LSERS commitment to promoting business within Louisiana whenever possible.

We have the following comments:

**EX-OFFICIO MEMBERS**

Jay Dardenne  
Secretary of State

John Kennedy  
State Treasurer

D. A. "Butch" Gautreaux  
Chairman, Senate  
Retirement Committee

Joel C. Robideaux  
Chairman, House  
Retirement Committee

Recommendation 1 & 2: LSERS agrees with these recommendations and has updated and removed those brokers no longer in good standing from the list of Louisiana broker-dealers and will review the list at least annually in the future.

Objective 2: LSERS agrees that the system is in compliance with the requirement to direct at least 10% of all domestic equity trades through Louisiana incorporated broker-dealers.

**EXECUTIVE DIRECTOR**

Charles P. Bujol

**ASSISTANT DIRECTOR**

Debra H. Dudley

**EXECUTIVE COUNSEL**

Warren D. Ponder

**ADMINISTRATIVE ASSISTANT**

Jennifer Champagne

Regarding LSERS interpretation of "best execution": LSERS fixed income manager Orleans Capital obtains bids from Louisiana broker-dealers on 100% of their trades. Orleans Capital's trading activity was 3.1% of the total fixed income trading during the audit period and their trading should be included as **compliant** pursuant to the "best execution" portion of the statute.

LSERS other fixed income managers purchases large amounts of mortgage and asset backed pooled securities. These security pools are created/securitized by the large, non Louisiana, firms and in most cases "best execution" can only be

achieved by dealing with these non-Louisiana based firms that specialize in mortgage / asset backed securities, especially on the initial purchase. Unlike an agency or corporate bond issue, each security has its own pool of mortgages / assets with different geographic location, credit scores, prepayment history etc. making it a unique security that is not easily comparison shopped for best price. The offering broker is likely the only firm with that particular pool (security) for sale at a given point in time.

LSERS managers also occasionally purchase new issue Government and Agency securities directly from the Federal Reserve. Best execution is obtained by eliminating paying any commission / markup to a broker and also should be considered in compliance with the statute.

Matter for Legislative Consideration 1: LSERS agrees that consideration should be given to Louisiana domiciled broker-dealers as long as it complies with the fiduciary responsibility to obtain best execution and believes the original intent of the legislation was to encourage opportunities for Louisiana firms.

Matter for Legislative Consideration 2: Consideration should be given to eliminating the “fixed income” component of the current law because of the difficulties of complying with and especially documenting “best execution” because of the characteristics of the securities being traded and the difficulty in getting competitive bids on asset backed securities as detailed in above. In the absence of complete elimination of this component, LSERS agrees with the recommendation to redrafted the statute to better define “best execution” efforts.

Recommendation 5: The computation of the commissions paid to Louisiana broker-dealers is a completely manual process and as such is very time consuming and prone to minor errors and oversights, however every effort is and will be made to ensure the accuracy of the reports submitted.

Thank you for the opportunity to express our comments and concerns regarding R.S. 11:266.1 and the audit of LSERS compliance with the statute.

Sincerely,



Brendan Brosnan  
Chief Investment Officer



Charles P. Bujol  
Director

## APPENDIX G: LSPRS Management's Response

See the following pages for the response we received from LSPRS regarding our conclusions and recommendations.

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# Louisiana State Police Retirement System

February 23, 2009

Mr. David K. Greer, CPA  
Assistant Legislative Auditor and  
Director of Performance Audit  
Louisiana Legislative Auditor  
1600 North Third Street  
P.O. Box 94397  
Baton Rouge, LA 70804-9397

Re: Management's Response to Performance Audit Report

Dear Mr. Greer:

Thank you for the opportunity to respond to the recommendations contained within the performance audit report as well as the opportunity to comment on the report. I would like to address each recommendation first, and individually as follows:

Recommendation 1 - I agree that LSPRS should develop a process to annually check the status of each Louisiana incorporated broker-dealer. I have requested that the system consultant develop an addendum to LSPRS' Investment Policy to include a process to ensure that each broker-dealer included on the system's broker-dealer list is in good standing.

Recommendation 2 - As part of the above requested policy, we will immediately remove any and all broker-dealers who are not in good standing.

Recommendation 3 - LSPRS will make every effort to comply with this recommendation. However, due to the nature of the software program that we are grouped within (with our custodian JPMorgan), we must consider any cost issues to the system if the recommended change necessitates a software upgrade. However, we will exhaust every effort to correct this issue.

Recommendation 4 - LSPRS will make every effort to comply with this recommendation.

Recommendation 5 - I agree that the Legislative quarterly reports should be reviewed for accuracy prior to submission and we will make every effort to assure the accuracy of these reports.

Overall, I was very impressed with the audit staff and with the professional manner in which they conducted this performance review. If we may be of service; or, additional information is needed, please do not hesitate to contact our office.

Sincerely,

A handwritten signature in cursive script that reads "Irwin L. Felps, Jr.".

Irwin L. Felps, Jr.  
Executive Director